

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:TEGE:EOEG:TEB-PLR-119044-02**

Date:

Re:

June 27, 2002

### LEGEND

Agency =

Independent System Operator =

State =

Cities =

Projects =

Bonds =

Y =

Dear :

This is in response to your request on behalf of the Agency for a ruling that the actions taken by some of its members to become participating transmission owners in

the Independent System Operator (the "ISO") will not be treated as a deliberate action that causes the Bonds to be private activity bonds under § 141 of the Internal Revenue Code of 1986 (the "1986 Code") or as industrial development bonds under § 103(b) of the Internal Revenue Code of 1954 (the "1954 Code").

## FACTS AND REPRESENTATIONS

The Agency represents that the following facts and circumstances are true or, in the case of events that have not yet occurred, the Agency expects them to be true. The Agency has acknowledged that if the facts and representations based on its expectations do not occur as expected, this letter ruling will have no binding effect on the Service.

The Agency is a joint powers agency and a public entity organized under the laws of the State. The Agency has Y members, each of which is a political subdivision of the State.

The Agency was created to permit its members to secure, by joint action among themselves, or by contract with other utilities, an adequate, reliable, and economical supply of electric power and energy. The Agency has the authority to jointly finance, own, develop, and operate electric generation and transmission facilities, and to issue bonds for the purpose of financing or refinancing all or any part of the costs of any authorized projects or purposes. The Agency currently has outstanding bonds, the Bonds, which financed or refinanced costs associated with several electric power transmission projects-- the Projects. Some of the Bonds are subject to the 1986 Code and others are subject to the 1954 Code.

The Agency owns an undivided ownership interest in, or is otherwise entitled to the transfer capability of, each of the Projects. Each Project is operated for the Agency by another entity. Several of the Agency's members (including one or more of the Cities) participate in each of the Projects. Every participating member in each Project has entered into a take-or-pay contract with the Agency for the purchase of its ratable portion of the transmission services provided by the Project. The contracts are for a term of years sufficient to amortize the Agency's debt burden with respect to the particular Project. Under these contracts, each participating City in a Project is entitled to a specific portion of the transmission services provided by that Project (the "City's entitlement" or, collectively, the "Cities' entitlements").

The electric industry is in the midst of significant changes to the way transmission services are purchased and sold as a result of the Energy Policy Act of 1992 and various orders of the Federal Energy Regulatory Commission (the "FERC"), including Order Nos. 888 and 2000 (referred to as "open access"). A primary purpose

of open access is to bring about increased competition at the wholesale energy level and, therefore, reduce the cost of wholesale electric energy.

To achieve this purpose, the FERC in Order No. 888 required, among other items, (1) the provision of open access transmission services on a non-discriminatory basis by all FERC-jurisdictional utilities that own, operate, or control interstate transmission facilities, and (2) that a nonFERC-jurisdictional utility that purchases transmission services from a FERC-jurisdictional utility and that owns or controls transmission facilities must make available open access transmission service to the FERC-jurisdictional utility under terms that are comparable to the service the nonFERC-jurisdictional utility provides itself. In Order No. 2000, the FERC required, among other items, each FERC-jurisdictional utility to make certain filings with the FERC with respect to forming and participating in a regional transmission organization (an "RTO"), which includes independent system operators. Order No. 2000 provides the required characteristics for RTOs such as independence, scope and regional configuration, operational authority, and short-term reliability. The Agency and its members are not subject to the jurisdiction of FERC under §§ 205 and 206 of the Federal Power Act, 16 U.S.C. § 824d and 824e (2001) (the "Act").

Several of the Agency's members, the Cities, are actively pursuing participation in the ISO. Each of the Cities would participate in the ISO by entering into an agreement (the "Agreement") with the ISO which would transfer to the ISO operational control over each participating City's entitlements. The ISO will provide open and non-discriminatory access to the transmission facilities under its operational control (the "ISO grid") pursuant to a transmission tariff, which has been approved by the FERC as being consistent with its rules promulgated under the Act.

The ISO will schedule transmission service over the ISO grid and collect fees from the transmission service recipients. There are three major categories of fees to be collected for the transmission services-- management fees, access fees, and usage fees.

The management fees, which are fees to compensate the ISO for the costs of services provided by it, are retained by the ISO. There are different types of management fees, each of which is a fee for the particular type of service provided.

The access fees are charged for use of the ISO grid. These fees are distributed to the participating ISO transmission line owners and the owners of entitlements, such as the Cities.

The usage fees, also known as "congestion fees," are collected during times of congestion in addition to the other fees for use of certain transmission lines. Whether particular lines are subject to usage fees is determined by the ISO. Congestion occurs when the amount of transmission service requested to be scheduled over a

transmission line subject to usage fees exceeds the capacity of the transmission line. The amount of the usage fee is established through a bidding process by the entities that desire to schedule transmission service over the transmission line.

Substantially all of the usage fees collected by the ISO are distributed to the holders of the “firm transmission rights” in respect to the particular transmission line subject to the usage fees. The ISO determines the amount of firm transmission rights to be assigned to each transmission line subject to usage fees. The ISO allocates the firm transmission rights among the ISO participants that own the transmission facilities or entitlements to the transmission facilities along the transmission line subject to usage fees. At a prescribed time, the ISO will sell a predetermined portion of the participants’ firm transmission rights at auction. At the auction, the firm transmission rights may be purchased by anyone for a one year period. After the one year period has expired, the ISO will place the firm transmission rights up for auction again. The ISO participants who have been allocated the firm transmission rights receive the proceeds of the auctions.

If any of the transmission lines to which the Cities own entitlements are determined by the ISO to be subject to usage fees, the ISO will determine the amount of firm transmission rights to be assigned to each transmission line. In that event, the amount of firm transmission rights allocated to the Cities will be commensurate with the amount of transmission capacity for the transmission line subject to usage fees that the Cities turn over to ISO operational control.

The Agreement may provide that at the end of an initial period, the ISO will put up for auction a prescribed amount of any firm transmission rights that have been allocated to a City. However, no City will allow the auction or other disposition of any firm transmission right allocated to it in respect of a Bond financed Project unless either: (i) the Agency first has obtained a ruling of the Service that such disposition would not cause the participation in the ISO to have the effect of being a sale, exchange, or other disposition of any of the Bond financed Projects to a nongovernmental person under § 1.141-7T of the temporary regulations that are in effect as of the date of this letter (the “current temporary regulations”); or (ii), if final or temporary regulations superseding the current temporary regulations have been issued and made applicable to the Bonds, the Agency has obtained a ruling of the Service or an opinion of a nationally-recognized bond counsel firm, that such sale or relinquishment of firm transmission rights will not adversely affect the tax-exempt status of the Bonds.

After entering into the Agreement, the Cities will retain ownership of their entitlements and the burdens associated therewith (including the obligation to make payments to the Agency sufficient to provide for payment of the debt service on Bonds and for payment of the costs of operating and maintaining the associated transmission lines). The Cities also will retain the right to dispose of those entitlements, subject to the consent of the ISO, which consent may not be unreasonably withheld.

The Agency represents that, if it is relying on this ruling, it will apply the provisions of § 1.141-7T(f)(5) of the current temporary regulations to the Bonds.

## LAW AND ANALYSIS

Generally, under § 103(a) of the 1986 Code, gross income does not include interest on any state or local bond. Section 103(b)(1) provides that interest on a state or local bond is not excluded from gross income if the bond is a private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) defines the term private activity bond to mean any bond issued as part of an issue which meets either (1) the private business use test and the private security or payment test (the “private business tests”), or (2) the private loan financing test.

Section 141(b)(1) states that except as otherwise provided, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(2) provides that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or in payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(b)(6)(B) defines private business use to mean use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Section 141(b)(6)(A) provides that use as a member of the general public is not taken into account.

Section 1.141-2(d)(1) provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business use tests or the private loan financing test. Section 1.141-2(d)(1) further provides that an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of the private business tests or the private loan financing test to be met.

Section 1.141-7T(f)(5)(ii) provides that an action is not treated as a deliberate action under § 1.141-2(d) if it is taken to implement the offering of non-discriminatory, open access tariffs for the use of transmission facilities financed by an issue in a manner consistent with rules promulgated by the FERC under §§ 205 and 206 of the Federal Power Act (or comparable provisions of state law). Section 1.141-7T(f)(5)(ii) also provides that this exception does not apply to the sale, exchange, or other

disposition of transmission facilities to a nongovernmental person. Section 1.141-15T(f)(1) provides that in general § 1.141-7T(f)(5) applies to bonds sold on or after January 19, 2001 that are subject to § 1301 of the Tax Reform Act of 1986, 1986-3 C.B. (Vol. 1) 1, 519. However, § 1.141-15T(i) provides that § 1.141-7T(f)(5) may be applied to any bonds.

Sections 103 and 141 to 150 of the 1986 Code were enacted by § 1301 of the Tax Reform Act of 1986 (the "1986 Act"). Interest on bonds which are not subject to § 1301 may be excluded from gross income under §§ 103 or 103A of the 1954 Code, which provide similar rules.

Section 1.141-7T(f)(5)(ii) may be applied to any bonds, including bonds subject to the 1954 Code. We conclude that entering into the Agreement with the ISO will not be treated as a deliberate action with respect to the Bonds because it is an action described in § 1.141-7T(f)(5)(ii). The action is being taken to implement the offering of non-discriminatory, open access tariffs for the use of transmission facilities financed by an issue in a manner consistent with the rules promulgated by the FERC under §§ 205 and 206 of the Federal Power Act. Furthermore, there is no sale, exchange, or other disposition of the Bond financed Projects to a nongovernmental person.

## CONCLUSION

The Cities' entering into the Agreement with the ISO will be an action described in § 1.141-7T(f)(5)(ii) and will therefore will not be treated as a deliberate action by the Agency for purposes of either the 1986 Code or the 1954 Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed as to whether the Bonds are tax-exempt under § 103, and no opinion is expressed as to whether selling the firm transmission rights (the rights to collect the usage fees) would constitute a deliberate action. Also, because we determined that joining the ISO will not be a deliberate act, it was not necessary to determine whether it will cause the private business tests or the private loan financing test to be met.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representative.

Sincerely,

Assistant Chief Counsel  
(Exempt Organizations/Employment Tax  
Government Entities)

By: \_\_\_\_\_  
Timothy L. Jones  
Assistant Branch Chief,  
Tax Exempt Bond Branch